2012

Give Mexico a Chance

Looney, Robert

Give Mexico a Chance, Foreign Policy, July 16, 2012
http://hdl.handle.net/10945/48230

Give Mexico a Chance

It wouldn't actually be that hard to restore Mexico's economic fortunes -- if the new president is willing to show some backbone.

BY ROBERT LOONEY

Mexico's tepid economic performance in the last decade has been a major disappointment -- and is one reason why the PRI, the less-than-democratic political party that was ousted in 2000 after 71 years of rule, has just returned to power in the country's presidential election. The economy, whose prospects seemed so bright in the wake of the creation of the North American Free Trade Agreement and the reforms of the 1990s, has been drifting. And it has lost ground to the other big Latin American economy, Brazil. Between 1982 and 2010, Brazil's per capita income increased from 65 percent of that of Mexico to 80 percent.

Yet, just when everyone seemed ready to throw in the towel, the economy is showing signs of fulfilling its potential. Mexico grew by 4.0 percent in 2011, and the IMF is forecasting gains of 3.6 percent for 2012 -- hardly stellar for an emerging-market economy, but better than Brazil, with corresponding rates of 2.7 percent and 3.0 percent. What's more, Mexico has managed to grow in spite of the surge of drug-related violence in key industrial zones.

While this reversal of fortune vis-à-vis Brazil may simply reflect different positions in the business cycle (the two economies are rarely in phase), it does raise some intriguing questions. Is Mexico better situated to thrive in an uncertain global economic environment marked by the eurozone crisis and the slowdown of several major emerging economies, notably China? If so, what must President-elect Enrique Pena Nieto do to maintain the momentum?

It's tempting to attribute Brazil's economic successes and Mexico's lackluster performance to their respective approaches to economic policy. Mexico has worked doggedly to implement the neo-liberal Washington Consensus approach to macroeconomic management -- budget discipline, central bank independence, anti-inflationary monetary policy, and pro-market liberalization, including the development of a truly private banking system. In contrast, Brazil has mixed market neo-liberalism with an eclectic, proactive approach to economic policy; its "heterodox" features include a large, partially state-owned banking system with complex, discriminatory rules for credit allocation, and reliance on a witch's brew of state-led investment strategies aimed at eliminating infrastructure bottlenecks.

Mexico's adoption of the Washington Consensus policies, it should be remembered, was not entirely voluntary. Once the country tied its fortunes to NAFTA, a neo-liberal agenda emphasizing price and exchange rate stability was needed to take full advantage of opportunities in the relatively open U.S. market. And joining NAFTA did pay off in terms of a tsunami of exports, nearly 80 percent of which end up in the U.S. By contrast, Brazil is still a fairly closed economy that has been diversifying its dependence on trade with the developed economies by deal-making in emerging markets. The timing (at least until this year) has been impeccable, allowing Brazil to surf the wave of commodity demand from Asia.

Brazil has also fed the expectations of a rapidly growing middle class with plentiful consumer credit. The result has been visible gains in living standards (especially at the bottom end), but at the cost of greater volatility in prices, interest rates, and currency exchange rates. This has complicated economic management, and may (along with the country's low rates of savings and the decline in commodity export prices) leave policymakers with little room to dodge the next downturn.

While it is fashionable in some quarters to attribute Brazil's higher growth rates to the country's pragmatic approach to economic management and Mexico's adherence to the neo-liberal gospel, I believe Mexico's economic performance is largely a product of the demand for Mexican products by the U.S. The numbers certainly support this view: The IMF found a high correlation between Mexican exports and GDP, with changes in exports statistically accounting for 86 percent of the variations in the country's growth rate between 1996 and 2010.

Aaron Tornell (UCLA) and Gerardo Esquivel (El Colegio de Mexico) argued back in 1995 that Mexico's potential gains from the free trade agreement didn't end with lower tariffs in Mexico's biggest foreign market. They hoped that NAFTA would unleash domestic forces able to push a whole host of growth-facilitating reforms to completion. Successful exporters, they suggested, would have a big stake in making the rest of the economy more competitive because it would lower their costs. Hence they would be in the vanguard on issues ranging from education, to transportation, to anti-monopoly regulation.

But most of those reforms were blocked by entrenched interests, many of them remnants of the corporatist economic system created in the 1930s by the PRI. The result has been a two-speed economy, based on a dynamic export sector that must shoulder the burden of an unproductive domestic economy.

The newly elected Pena Nieto has promised reforms that could restore the vibrant growth of the 1950s and 1960s. These include a range of economists' greatest hits -- everything from broadening the tax base,to permitting competition for Pemex, the notoriously inefficient, union-dominated national oil company. However, in light of the realities that (a) the PRI does not have an absolute majority in Congress, and (b) the PRI's old guard is hardly keen for reform, this will be a daunting task.

Happily, major initiatives may not be necessary to sustain the growth momentum a while longer. The country's economic regulators, who have considerable independence, have been playing a much more active role in fighting monopoly power, even taking on telecom oligarch Carlos Slim, the world's richest man (though with limited success). By no coincidence, last year Mexico jumped eight places on the World Economic Forum's Competitiveness Index, to 58th in the world.

But regulatory initiatives alone can only go so far. Luckily, other forces that don't require the approval of the legislature are also pushing the economy in the right direction. First, Mexico is gaining an edge in the U.S. market thanks in large part to the declining competitiveness of China, where wages are rising faster than productivity and the currency has been appreciating against the dollar. Second, U.S. manufacturing has become leaner and more flexible, making it more competitive in global markets. And these manufacturers are likely to carry Mexican firms, which are deeply integrated as suppliers of manufactured components, along for the ride. Third, Mexico's preferential access to the U.S. market serves as a magnet for direct investment by multinationals that are increasingly focused on shortening their supply chains -- a process known in biz-school-speak as "near-shoring."

Mexico's neo-liberal agenda, overreliance on the U.S. market, inability to match China's costs in third markets, and crony capitalist environment have been seen as liabilities that condemned the economy to sub-par growth. The crony capitalism isn't going away anytime soon. But other "burdens" are looking more and more like assets.

Meanwhile, President Pena Nieto will be trying to chip away at the barnacles slowing the economy. And while it's hard to believe that he will get far in plans to reduce drug-related violence -- proximity to the U.S. market is not always an advantage -- the payoff in terms of investment and economic efficiency would be enormous. With a little luck (OK, a lot of luck and even more determination), he could restore the luster lost by the PRI through decades of corruption and thuggish rule.

Ronaldo Schemidt/AFP/GettyImages